



October 24, 2005

Mr. Christopher Murphy, Director
Office of Traffic Safety
7000 Franklin Boulevard, Suite 440
Sacramento, CA 95823

Dear Mr. Murphy:

Final Report: Office of Traffic Safety—Internal Control Review

Enclosed is our final report on the Office of Traffic Safety's (Department) internal control as of March 24, 2005. The Department of Finance (Finance), Office of State Audits and Evaluations, performed this review in accordance with the Financial Integrity and State Manager's Accountability Act of 1983, Government Code Section 13400 et seq.

The Department's written response is included herein. Implementation of the proposed corrective actions will help strengthen the Department's internal control and reduce the risk of errors or irregularities.

In accordance with Finance's policy of increased transparency, this report will be placed on the Finance website. We appreciate the assistance and cooperation of staff and management during our review. If you have any questions, please contact Susan M. Botkin, Manager, or Cheryl Lyon, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by Janet I. Rosman

Janet I. Rosman, Assistant Chief
Office of State Audits and Evaluations

Enclosure

cc: Ms. Marilyn Sabin, Assistant Director, Program Planning and Operations, Office of Traffic Safety
Mr. William Terrell, Assistant Director, Administration and Support, Office of Traffic Safety
Ms. Michele Meadows, Staff Services Manager I, Administrative Special Projects, Office of Traffic Safety
Ms. Debbie Hrepich Senior Accounting Officer, Fiscal Services, Office of Traffic Safety

AN INTERNAL CONTROL REVIEW

Office of Traffic Safety

Prepared By:
Office of State Audits and Evaluations
Department of Finance

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The primary responsibility of the California Office of Traffic Safety (Department) is to administer the California Traffic Safety Program. Under the provisions of state law, the office conducts a wide range of activities designed to reduce deaths, injuries, and property damage that result from traffic accidents. Activities include: (1) developing the California Highway Safety Plan, which identifies major traffic safety problems, appropriate countermeasure programs, and available state and federal funds; (2) administering funds to state and local governmental entities in the form of project grants; and (3) coordinating statewide traffic safety programs and activities. The Department receives funding from the State Transportation Fund as well as the Federal Trust Fund and is located in Sacramento.

Department management is responsible for the establishment and maintenance of internal and administrative controls. These controls are defined as a process to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting; (b) effectiveness and efficiency of operations; and (c) compliance with applicable laws and regulations. This definition includes five interrelated components.

- *Control environment* sets the tone of an organization, influencing the control consciousness of its staff. It is the foundation for all other internal control components, providing discipline and structure.
- *Risk assessment* is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.
- *Control activities* are the policies and procedures that help ensure management directives are carried out.
- *Information and communication* are the identification, capture, and exchange of information in a form and time frame that enable staff to carry out their responsibilities.
- *Monitoring* is the process that assesses the quality of internal control performance over time.

The objective of our internal control review was to assist the Department in complying with the Financial Integrity and State Managers' Accountability Act of 1983. Specifically, we assisted the Department in determining whether: (1) assets are safeguarded from unauthorized use or disposition; (2) financial transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of reliable financial statements; and (3) financial operations are conducted in accordance with State Administrative Manual guidelines, and certain other state laws and regulations, as well as the Department's policies and procedures.

Our review did not include an evaluation of the efficiency or effectiveness of the Department's operations, or the accomplishment of program goals or objectives.

This report is intended for the information and use of the Department management and should not be used for any other purpose. However, the report is a matter of public record and its distribution is not limited.

STAFF:

Susan M. Botkin, CGFM
Manager

Cheryl L. Lyon, CPA
Supervisor

Dan Jenkinson
Alexis Calleance

EXECUTIVE SUMMARY

During our review of the Office of Traffic Safety's (Department) internal control as of March 24, 2005, we identified areas where controls were in place and working as intended, and also identified areas where controls could be improved to reduce the risk of errors, irregularities, and material misstatements. Our findings and observations are summarized below, for further analysis refer to the Findings and Recommendations section of this report.

Administrative Controls: The Department's documentation of policies and procedures are not sufficient to ensure proper control and accountability over the operations of the Department. Specifically, policies and procedures for information technology, budgeting, cash receipts, receivables, purchasing, cash disbursements, revolving fund, personnel and payroll, contracts, fixed assets, and financial reporting are not adequately documented. Although the Department maintains written policies and procedures for a number of the accounting cycles, these manuals have not been reviewed or revised since 1994. See the Findings and Recommendations section for further analysis.

Information Technology: The Department's information technology controls appear adequate to ensure the overall reliability and integrity of data. Although no policies and procedures over the Information Technology process are documented, we observed that data integrity is assured through avoidance of key person dependency as well as through input, processing, and output controls.

Budget: The Department's controls over its budget functions appear adequate to ensure the reliability and integrity of data. Although the policies and procedures over the budget process are not documented, the Department's budget is developed through input and review from various members of management and the Department of Finance Budget Officer.

Cash Receipts: The Department's cash receipts controls are not sufficient to ensure assets are properly safeguarded. Our tests of controls identified numerous weaknesses. Specifically, the Department does not maintain a formal record of who has access to the Department safe or when the combination is changed. The Department has not transferred its cash receipts to the State Treasury timely. The Department has also failed to transfer its quarterly Statewide Cost Allocation Plan recovery amounts to the General Fund timely. Furthermore, the policies and procedures over the cash receipts process are outdated. See the Findings and Recommendations section for further analysis.

Receivables: The Department's receivables controls appear adequate. Although the policies and procedures over the receivables process are not documented, we observed that controls are in place to ensure the proper processing of receivable amounts. We also observed that supporting documentation is properly maintained for all receivable accounts.

Purchasing: The Department's purchasing controls appear adequate to ensure that purchases are justified, reasonable, consistent with laws and regulations, and that the Department's assets are appropriately safeguarded when received. Although the policies and procedures over the purchasing process are not documented, we observed that purchases of goods and services are proper, economic, and include appropriate authorizations, and that invoices are reviewed and processed promptly and accurately.

Cash Disbursements: The Department's cash disbursements controls are not sufficient to ensure assets are appropriately safeguarded. Specifically, the separation of duties over the cash disbursement process is inadequate, and the policies and procedures over the cash disbursements process are outdated. See the Findings and Recommendations section for further analysis.

Revolving Fund: The Department's revolving fund controls appear adequate to ensure the safeguarding of the state's assets. Although the policies and procedures over the revolving fund process are not documented, revolving fund advances are less than three percent of the Department's budget, the revolving fund has not been consistently overdrawn, travel and salary advances are appropriately issued and are cleared timely, and reconciliation's are prepared accurately and timely.

Payroll/Personnel: The Department's controls over the personnel and payroll functions are not sufficient to ensure the reliability and integrity of data. The Department has contracted with Caltrans to perform personnel services associated with maintaining the Department's records and all aspects of the Department's personnel transactions. The Department performs no reconciliation of its record of employee hours and leave balances with the Caltrans record of this information. Also, the policies and procedures over the contract function are outdated. See the Findings and Recommendations section for further analysis.

Contracts: The Department's contracting controls appear adequate. Although the policies and procedures over contract controls are not documented, we observed that an adequate separation of duties exists, contracts are supported by appropriate documentation, contract modifications and amendments appeared proper, and contracts were properly authorized and monitored.

Fixed Assets: The Department's fixed asset controls appear adequate to ensure the appropriate safeguarding of state assets. Although the policies and procedures over the fixed asset controls are outdated, we observed that subsidiary records are maintained, acquisitions and dispositions of fixed assets are properly authorized and recorded, and an adequate separation of duties exists.

Financial Reporting: The Department's financial reporting controls appear adequate. We observed that required financial statements are properly prepared, certified, and submitted timely, and that valid supporting documentation is available for year-end accounts payable balances.

This report is intended to assist Department management in focusing attention on areas of deficiency, strengthening internal control, and improving operations.



AUDITOR'S REPORT

Mr. Christopher Murphy, Director
Office of Traffic Safety
7000 Franklin Boulevard, Suite 440
Sacramento, CA 95823

We have reviewed the Office of Traffic Safety's (Department) internal control as of March 24, 2005, for conformity with Government Code Section 13400 et seq. Our review included obtaining an understanding of the internal control through observations and interviews, testing and evaluating the design and operating effectiveness of the internal control, and performing other procedures we considered necessary.

The Department's management is responsible for establishing and maintaining adequate internal control. This responsibility, in accordance with Government Code Section 13400 et seq., includes documenting internal control, communicating requirements to employees, and assuring that the internal control is functioning as prescribed. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of internal control are to provide reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition.
- Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements.
- Financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual.

Because of inherent limitations in internal control, misstatements due to error or fraud may occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

In reviewing the Department's internal control as of March 24, 2005, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a condition that precludes the Department's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis. We believe the reportable conditions concerning administrative controls are material weaknesses. These weaknesses and other reportable conditions are described in the *Findings and Recommendations* section of this report.

This report is intended solely for the information and use of Department management and is not intended to be and should not be used by anyone other than this specified party. However, this report is a matter of public record and its distribution is not limited.

Original signed by Janet I. Rosman

Janet I. Rosman, CPA
Assistant Chief, Office of State Audits and Evaluations

March 24, 2005

FINDINGS AND RECOMMENDATIONS

During our review of the Office of Traffic Safety's (Department) internal control as of March 24, 2005, we noted that many controls were functioning as intended. However, we also identified areas where controls are either not in place or functioning as intended, and where corrective action is necessary. The condition related to Administrative Controls is considered a material weakness. If left uncorrected, this weakness could compromise the accuracy of the Department's financial operations and financial statements.

Administrative Controls

Administrative or managerial controls relate to operational efficiency, adherence to managerial policies, and management's authorization of transactions. Department management is responsible for overseeing activities conducted within their agencies. This responsibility includes the establishment and maintenance of internal accounting and administrative controls over operations. Each system an entity maintains to regulate and guide operations should be documented through flowcharts, narratives, desk procedures, and organizational charts. Department management's failure to ensure operating policies and procedures are current and sufficiently documented indicates a weakness in the effectiveness of the Department's administrative controls.

FINDING 1 Inadequate Documentation of Policies and Procedures

Condition: The Department does not maintain adequate documentation describing the policies and procedures associated with the following areas:

- Information Technology
- Budgeting
- Cash Receipts
- Receivables
- Purchasing
- Cash Disbursements
- Revolving Fund
- Personnel and Payroll
- Contracts
- Fixed Assets
- Financial Reporting

We observed that many policies and procedures are not documented and those which are documented, are not formalized in a Department approved manual. For example, the Department maintains a procedures manual, however, the manual has not been reviewed and/or revised since 1994. Failure to adequately document and maintain current policies and procedures in a centralized manual increases the risk of inconsistencies

and errors within operational processes as well as diminishes the Department's training effectiveness should a turnover in staff occur.

Criteria: State Administrative Manual (SAM) Section 20050 states, "the elements of a satisfactory system of internal accounting and administrative controls, shall include a system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues and expenditures."

Recommendation: Ensure all operational processes and procedures are appropriately documented, revised periodically, and maintained in a centralized manual.

Cash Receipts

Effective internal control over the cash receipts process is necessary to ensure that controls are adequate to safeguard cash, and to prevent and timely detect any errors or irregularities. We identified the following weaknesses in the Department's internal control over cash receipts.

FINDING 2 Inadequate Safeguarding of the Department's Safe

Condition: The Department maintains no formal record identifying who has access to the Department safe or when the combination was last changed. Thus we were unable to verify who has access to the safe or if the combination is changed when an employee who has knowledge of the combination leaves or no longer requires access. The Department stores blank checks in the safe and the absence of a formal record of employees with access to the safe increases the chance of theft or fraud.

Criteria: SAM Section 8024 states, "A record will be kept showing:
(a) the date the combination was last changed, and
(b) the names of persons knowing the present combination."

Recommendation: Formally document and maintain a log detailing who has access to the safe and the dates the combination is changed. Additionally, ensure the safe combination is changed when staff turnover occurs or when a staff member no longer requires access.

FINDING 3 Untimely Posting and Transfer of Cash Receipts

Condition: The Department has not remitted cash receipts to the State Treasury, or posted its non-revolving fund cash receipts to the general ledger since fiscal year 2003-04, resulting in a loss of interest earnings and the possible material misstatement of the Department's accounting records and financial statements.

Criteria: SAM Section 8091 states, "regardless of the amount, agencies will remit to the State Treasury all moneys determined to be revenue, reimbursements, abatements, and operating revenue within 30 days following the date collected, unless more frequent remittances are required by law, regulation or circumstance."

SAM Section 20050 states, "the elements of a satisfactory system of internal accounting and administrative controls, shall include a system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues and expenditures."

Recommendations: Remit cash receipts to the State Treasury within the time limits as specified by SAM.

Record all cash receipts in the accounting records on a timely basis.

FINDING 4 Untimely Transfer of Statewide Cost Allocation Plan Recovery Amounts

Condition: The Department failed to transfer its Federal Fiscal Year (FFY) 2003-04 fourth quarter Statewide Cost Allocation Plan (SWCAP) recovery amounts to the General Fund within 30 days after the end of the quarter as required by SAM. The Department transferred these recoveries on February 8, 2005, approximately three months after the October 30 FFY fourth quarter due date.

Criteria: SAM Section 8755.2 states, "to further the state's full cost recovery objective, GC Sections 13332.01-13332.02, require departments to recover SWCAP costs from the federal government and to transfer the SWCAP recoveries to the General Fund with 30 days after the end of each quarter."

Recommendation: Submit SWCAP recoveries to the General Fund within the time limits specified by SAM.

Cash Disbursements

Effective internal control over the cash disbursement process is necessary to ensure that controls are adequate to safeguard cash, and to prevent and detect timely any errors or irregularities. We identified the following weakness in the Department's internal control over cash disbursements.

FINDING 5 Inadequate Separation of Duties

Condition: The Department lacks adequate separation of duties over its cash disbursements functions. Specifically, the same employee:

- Has access to the blank check stock
- Approves check disbursements
- Signs checks
- Performs the bank reconciliation
- Has the authority to input data into Calstars
- Approves Calstars claim schedules

As a result, the risk of loss or theft of the states' assets is increased.

Criteria: SAM Section 20050 states, "GC 13403 states the elements of a satisfactory system of internal accounting and administrative controls, shall include, a plan of organization that provides segregation of duties appropriate for proper safeguarding of state assets."

Recommendation: Separate the cash disbursement functional duties.

Personnel/Payroll

Effective internal control over the personnel and payroll functions is required to ensure that Department staff are properly appointed, staff are not separated with outstanding advances or in possession of Department assets, and payroll information is processed accurately and timely. We noted the following weakness in the controls over personnel and payroll.

FINDING 6 Lack of Reconciliation of Payroll Information

Condition: The Department contracts with Caltrans to perform personnel services associated with maintaining personnel records and all aspects of the Department's personnel transactions. However, the Department does not perform a reconciliation of its record of employee hours and leave balances with the Caltrans' record in order to ensure accuracy. We selected six employees for testing and found that all, 100 percent, had discrepancies between the Department's records and Caltrans' records ranging from 3 hours to 145 hours.

Criteria: SAM Section 20050 states, "the elements of a satisfactory system of internal accounting and administrative controls, shall include a system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues and expenditures."

Recommendation: Perform monthly reconciliations of employee hours and leave balances to the Caltrans' record. Timely research and resolve identified discrepancies.

CONCLUSION

Our review of the Office of Traffic Safety's (Department) internal control presents opportunities for the Department's management to correct identified weaknesses and improve its operations. We believe internal controls would be strengthened and the Department would operate more efficiently and effectively if management implements our recommendations. The internal control weaknesses, if left uncorrected, increase the risk that material errors or irregularities could occur and remain undetected and could affect the accuracy of the Departments financial statements.

The findings in this report are based on fieldwork performed between January 31, 2005 and March 24, 2005. We presented these findings and non-reportable issues to the related divisions and units at the completion of each cycle, at the interim pre-exit meeting, and finally during our exit conference on April 11, 2005.

RESPONSE

MEMORANDUM

To: Samuel E. Hull, Chief
Office of Audits and Evaluations
Department of Finance
915 L Street
Sacramento, CA 95814

Date: October 4, 2005

From: Office of Traffic Safety
7000 Franklin Boulevard, Suite 440
Sacramento, CA 95823-1899

Subject: Internal Review Audit Response

We have reviewed the findings and recommendations contained in your Draft Audit Report dated August 23, 2005. The following responses outline our status relative to each of your recommendations.

I. Findings: Inadequate Documentation of Policies and Procedures

The OTS Fiscal Unit uses the detailed Calstars Manual and State Administrative Manual (SAM) procedures to help ensure internal accounting and administrative controls are in place. Additionally, OTS utilizes desk procedure manuals, which have not been updated since 1994.

To that end, the OTS Performance Improvement (PI) Task Force has been tasked with reviewing and documenting all OTS internal processes to include developing system modifications and revisions to existing process and procedure documents. This project has a scheduled completion date of July 1, 2006.

II. Findings: Inadequate Safeguarding of the Department's Safe

In accordance with SAM Section 8024, OTS has established a log to document all personnel that have access to the safe in addition to recording the date the combination is changed, and/or any additions or deletions of employee access. The Assistant Director of Administration will monitor the log and ensure the combination is changed immediately upon the separation of an employee that has access to the safe or when an employee no longer requires access. Currently, an Accountant I and an Accounting Technician have access to the safe.

III. Findings: Untimely Posting and Transfer of Cash Receipts

OTS has an established cash receipts processing policy, however the nine receipts in question, which totaled \$5,738 occurred during a transitional period due to vacancies within the unit and a subsequent redirection of duties and responsibilities. OTS has re-emphasized the importance of this requirement and will ensure all receipts are recorded, deposited and remitted within the required time frames in accordance with SAM Section 8091 requirements.

IV. Findings: Untimely Transfer of Statewide Cost Allocation Plan Recovery Amounts

OTS concurs with this recommendation. OTS has implemented a new procedure, which will ensure all future transfers are processed within the required time frames in accordance with SAM Section 8755.2.

V. Findings: Inadequate Separation of Duties

It should be noted that the Senior Accounting Officer (SAO) Supervisor must have the ability to sign checks, approve claim schedules, and input data into Calstars. The SAO does not sign claim schedules or checks in which the SAO is a payee. Also, to clarify the statement that this position approves check disbursements, the SAO merely certifies that funds are available and the Assistant Director of Administration approves the check disbursement. The SAO no longer has access to the safe, and the duty of the bank reconciliation has been reassigned to an Accountant I Specialist, (not the same Accountant I that has access to the safe).

VI. Findings: Lack of Reconciliation of Payroll Information

OTS concurs with this finding. On July 1, 2005, OTS implemented a monthly verification process with our Caltrans personnel specialist to verify and ensure accuracy in posting of employee leave balance information. The leave balances are reconciled monthly and all discrepancies are resolved within the current month.

If you have any questions, please contact William H. Terrell, Assistant Director of Administration, at (916) 262-2977.

Original signed by Christopher J. Murphy

CHRISTOPHER J. MURPHY
Director

WHT:kn